IN THE SUPREME COURT
Appeal from the Court of Appeals
Honorable E. Thomas Fitzgerald, Janet T. Neff, and Helene N. White

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ALBERTA STUDIER, PATRICIA M. SANOCKI, MARY A. NICHOLS, LAVIVA M. CABAY, MARY L. WOODRING, and MILDRED E. WEDELL,

Plaintiffs-Appellees,

vs.

MICHIGAN PUBLIC SCHOOL EMPLOYEES RETIREMENT BOARD, MICHIGAN PUBLIC SCHOOL EMPLOYEES RETIREMENT SYSTEM, MICHIGAN DEPARTMENT OF MANAGEMENT AND BUDGET, and TREASURER OF THE STATE OF MICHIGAN,

Defendants-Appellants.

Supreme Court
Docket No. 125766

Court of Appeals
Docket No. 243796

Ingham County Circuit Court
Case No. 00-92435-AZ

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BRIEF ON APPEAL—APPELLEES'

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PLAINTIFFS-APPELLEES' BRIEF ON APPEAL

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COUNTER-STATEMENT OF QUESTION PRESENTED

I. **DID THE COURT OF APPEALS CORRECTLY HOLD THAT MCL 38.1391(1) CREATED A CONTRACT TO PROVIDE HEALTH BENEFITS FOR THE RETIRANTS FROM THE MICHIGAN PUBLIC SCHOOL EMPLOYEES RETIREMENT SYSTEM, WHICH IS PROTECTED FROM DIMINISHMENT OR IMPAIRMENT UNDER THE UNITED STATES AND MICHIGAN CONSTITUTIONS?**

The Court of Appeals answered "Yes."
The Ingham County Circuit Court answered "Yes."
Defendants-Appellants would answer "No."
Plaintiffs-Appellees would answer "Yes."

COUNTER-STATEMENT OF PROCEEDINGS AND FACTS

Nature and Character of the Pleadings and Proceedings.

In this action, Plaintiffs-Appellees are seeking a declaratory judgment and injunctive relief. The action was commenced September 21, 2000. At the time of filing their Complaint, Plaintiffs-Appellees also filed a Motion for Preliminary Injunction and supporting Brief.

The First Amended Complaint alleged that certain increases in the drug co-pays and deductibles levied by Defendant-Appellant Michigan Public School Employees Retirement Board (hereinafter the "Retirement Board") against Plaintiffs-Appellees, pursuant to the health insurance plan of the Retirement Board, were violative of their rights under US Const, art I, §10 and Mich Const 1963, art 1, §10 and art 9 §24.

The named Plaintiffs-Appellees are six retirees from Defendant-Appellant Michigan Public School Employees Retirement System (hereinafter "MPSERS").[1] They are a good representative cross-section of all the retirees from the MPSERS. Some were professional employees and some were support personnel employed by their respective public school employers. The Complaint was filed on behalf of each Plaintiff-Appellee, and on behalf of all retirees of the MPSERS. Although each retiree from the MPSERS has in certain respects a different set of circumstances (different retirement incomes, different health conditions, etc), the provisions of the health plan provided by MPSERS are, in all material respects, the same when applied

[1]The MPSERS was established by the Public School Employees Retirement Act of 1979, 1980 PA 300, being MCL 38.1301, *et seq*, hereinafter referred to as the "Retirement Act."

to all retirees. The gravaman of Plaintiffs-Appellees' Complaint is that the increases in the drug co-payments and deductibles exacted against them in 2000 and which apply to them *ad infinitum*, amount to a substantial shift in the relative burden of paying for the health insurance plan provided for them in Section 91 of the Retirement Act.

On February 21, 2001, after reviewing the briefs and listening to oral arguments, the trial court issued its first Opinion regarding Plaintiffs-Appellees' First Amended Motion for Preliminary Injunction. (PA 194a - 204a.)[2] That Opinion made several holdings, and concluded with the following directive to the parties:

> The parties are directed to file affidavits and other documentary evidence of their choosing, and to file simultaneous briefs and reply briefs (one reply only) on the issue as to whether the changes imposed by Defendants and challenged in the present lawsuit constitute a significant impairment, as defined in this Opinion.

PA 204a.

Pursuant to that directive, the parties filed further briefs and affidavits and the trial court heard oral argument on May 25, 2001. In the trial court's second Opinion, dated August 28, 2001, it denied Plaintiffs-Appellees' Motion for Preliminary Injunction. (PA 246a - 249a.) The final paragraph of that Opinion stated:

> The Court wishes to give the parties one more opportunity to narrow the factual issues (or even decide the case) prior to trial. The Court therefore invites the filing of C(10) motion or motions for summary disposition. If necessary, the Court will move the trial date to give the parties and the Court sufficient time to complete this motion process.

PA 249a.

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[2]In order to prevent the duplication of appendices, references to Plaintiffs' Appendix submitted on November 12, 2004, in Supreme Court Docket No. 125765, which will be argued and submitted to the Court together with the present case, will appear as "PA __a."

The parties filed motions for summary disposition, submitted briefs and affidavits, and the trial court heard oral arguments on said motions on April 5, 2002. In an Opinion dated August 29, 2002, (PA 557a - 563a), Judge Lawrence Glazer granted Defendants-Appellants' Motion for Summary Disposition and dismissed this action without costs. Plaintiffs-Appellees appealed that decision to the Michigan Court of Appeals. On February 3, 2004, the Court of Appeals issued a published Opinion. (PA 567a - 577a.) That Opinion is the subject of this appeal.

Plaintiffs-Appellants filed a timely Application for Leave to Appeal on March 15, 2004, in Supreme Court Case No. 125765. In an Order dated September 16, 2004, this Court granted Plaintiffs-Appellants' Application. (PA 603a.) On the same date, this Court granted an Application for Leave to Appeal filed by Defendants-Appellants herein. (PA 604a.) The Orders in both cases indicated that the case was to be "argued and submitted to the Court together . . . at such future session of the Court as both cases are ready for submission."

Facts and Procedure Related to Docket No. 125766.

In his February 21, 2001 Order, Ingham County Circuit Court Judge Lawrence Glazer concluded that the health benefits at issue were protected against impairment by both US Const, art I, §10 and Mich Const 1963, art 1, §10, thus determining that Section 91 of the Retirement Act was contractual in nature. (PA 196a - 197a.)[3]

[3]It should be noted that Defendants-Appellants did not appeal any portion of that decision to the Court of Appeals. The general rule is that a question may not be raised for the first time on appeal to the Michigan Supreme Court. Swartz v Dow Chemical Co, 414 Mich 433, 446; 326 NW2d 804 (1982), citing Dation v Ford Motor Co, 314 Mich 152; 22 NW2d 252 (1946).

The Court of Appeals, in deciding Plaintiffs-Appellees' appeal on other grounds (namely, whether the granting of summary disposition to Defendants-Appellants was proper), stated:

> A state contractual obligation arises from legislation only if the legislature has unambiguously expressed an intention to create the obligation. *See, e.g.*, United States Trust Co v New Jersey, 431 US 1, 17, n 14; 97 S Ct 1505; 52 L Ed 2d 92 (1977). In order to prove that a statutory provision has formed the basis of a contract, the language employed in the statute must be "plain and susceptible of no other reasonable construction" than that the Legislature intended to be bound by a contract. Stanislaus Co v San Joaquin & King's River Canal & Irrigation Co, 192 US 201, 208; 24 S Ct 241; 48 L Ed 406 (1904). A statute can create a contract if the language and circumstances demonstrate a clear expression of legislative intent to create private rights of a contractual nature enforceable against the state. United States Trust, *supra* at 17, n 14; Blue Cross & Blue Shield of Michigan v Governor, 422 Mich 1; 367 NW2d 1 (1985).
>
> In Musselman I, the Supreme Court stated that "the defendants conceded that these statutes [including §91(1)] create a right to receive health benefits that may not be impair," *id.* at 505, n 1, and that "defendants concede that retirement health care benefits are contractual benefits subject to Const 1963, art 1, §10." *Id.* at 519, n 19. While these concessions are not binding in this litigation, the language of MCL 38.1391(1) demonstrates a clear expression of legislative intent to create contractual rights for public school employees. Health insurance is part of an employee's benefit package and the whole package is an element of consideration that the state contracts to tender in exchange for services rendered by the employee.

PA 576a; footnotes omitted.

It is this portion of the Court of Appeals' Opinion which is at issue in Defendants-Appellants' appeal to this Court. For the reasons set forth below, this Court should affirm the Court of Appeals' Decision on that issue.

The analysis of impairment/diminishment cases established in United States Trust Co of New York, Trustee v New Jersey, 431 US 1; 97 S Ct 1505; 52 L Ed 2d 92 (1977) *reh den* 431 US 975; 97 S Ct 2942 (1977), is particularly applicable to the facts of the present case. That analysis is three pronged. First, the Court must make a determination whether the statute, ordinance, or regulation in question amounts to a contract and, if so, what contractual benefit was given. Second, if a contract was entered into, did the State's subsequent actions amount to a "substantial impairment" of the contract. Third, even if a substantial impairment of the contractual right is found, the State, in rare circumstances, may be permitted to demonstrate that the substantial impairment is both reasonable and necessary to serve an important public purpose.

This Brief deals with the first prong of that analysis: Whether the health benefits described in MCL 38.1391(1) is a contractual obligation of the State to the retirants from MPSERS that cannot be diminished or impaired.

ARGUMENT

I. STANDARD OF REVIEW.

Plaintiffs-Appellees agree with the Standard of Review set forth in Defendants-Appellants' Brief on Appeal.

II. THE COURT OF APPEALS PROPERLY CONCLUDED THAT MCL 38.1391(1) CREATED CONTRACTUAL RIGHTS ON THE PART OF MPSERS' RETIRANTS WHICH ARE PROTECTABLE UNDER THE NON-IMPAIRMENT CLAUSES OF THE UNITED STATES AND MICHIGAN CONSTITUTIONS.

A. The case law of this and other states demonstrates that health benefits under Section 91(1) of the Retirement Act are "vested" and "contractual" and subject to constitutional protection.

The Court of Appeals' Opinion properly concluded that ". . . the language of MCL 38.1391(1) demonstrates a clear expression of legislative intent to create contractual rights for public school employees[9]." (PA 576a.) Part of the Court's thinking on that issue is disclosed in the language of footnote 9 which states:

> Because all of the plaintiffs in this case have retired and, therefore, have vested health benefits, a discussion about when health care benefits become vested is not necessary in this case.

Id.

The Court of Appeals' holding on that issue is the same as the trial court's holding thereon. At pp 12-14 of the trial court's Opinion of February 21, 2001, the Court thoroughly discussed whether the health benefits granted to retirees pursuant to MCL 38.1391(1) were contractual and subject to the protection afforded by the non-impairment clauses of the United States and Michigan Constitutions. (PA 195a - 197a.) The trial court expressly concluded that Plaintiffs-Appellees' rights to health benefits were "vested." The trial court concluded:

> Applying the principles explicated in the above-quoted cases, it appears to me that a statutorily created (*i.e.*, non-bargained for) retirement health care benefit "vests" for purposes of Article I, section 10 when the benefit has been formally adopted and described to active employees while they are still working, and those employees continue to provide services in expectation of those benefits. Once such employees have retired, they cannot take back the services which they already provided in expectation of all the compensation which they were promised. Therefore, even though the pension plan was never the subject of a collective bargaining agreement, it is still vested for purposes of Article I, section 10, just as was the benefit package in Helwig.
>
> In Tyler, the Court of Appeals made it clear that Article I, section 10 would have applied if the plaintiff had already been disabled at the time the coordination of benefits provision was enacted. This is the same thing as saying that the Constitution would have protected the plaintiff if the disability benefit had vested. I am aware of no Michigan court decision which holds to the contrary, *i.e.*, that a health plan or other non-cash retirement benefit has not vested after an employee has performed services under a promise or holding out of that benefit, and that employee has then retired.
>
> Therefore, Plaintiffs in the present case who perform services after the enactment of section 91(1) and adoption of a health benefit plan by the Board and who subsequently retired are entitled to claim the protection of Article I, section 10 of the federal and Michigan Constitutions.

Id; emphasis in original.

This ruling of the trial court and the subsequent ruling of the Court of Appeals that the health benefits in question are contractual obligations protected by US Const, art I, §10 and Mich Const 1963, art 1, §10 is legally sound and entirely consistent with prior rulings of Michigan appellate courts.

Campbell v Judges' Retirement Bd, 378 Mich 169; 143 NW2d 755 (1966), is determinative of the issue here presented. The Michigan Legislature, in 1956, placed

an "escalator clause" in the Judges' Retirement Act which granted pensions to retired circuit judges. The escalator clause set the judges' pension at "one-half of the salary currently being paid to circuit judges." (*Id*, at 177-178; emphasis added.) Under that Act, as circuit court judges' salaries increased, so did the retirement allowance of the retired circuit judges. In 1961, the Judges' Retirement Act was amended by the Legislature to eliminate the escalator clause and limit the amount of a retired circuit judge's pension to one-half of the salary being paid by the State "at the time of [the judge's] retirement." (*Id*, at 178; emphasis added.) In 1963, the Michigan Legislature increased the amount of the State's contribution to circuit judges' salaries from $12,500 to $15,000. The Judges' Retirement System Board, after consultation with the Attorney General, refused to increase retired circuit court judges' pensions to one-half of $15,000 from one-half of $12,500. An action by several retired circuit court judges ensued. The retired judges predicated their lawsuit on the State's violation of the non-impairment of contracts provisions in the United States and Michigan Constitutions, *i.e.*, US Const, art I, §10 and Mich Const 1963, art 1, §10.

The state defendants in Campbell, *supra*, argued that no vested or contractual rights were created by the 1956 Act creating the so-called "escalator clause" and that the State was entirely free to eliminate the escalator clause. Ruling for the retired judges in Campbell, *supra*, the Supreme Court stated:

> Michigan Constitution of 1908, art 2, §9, followed by Michigan Constitution of 1963, art 1, §10, and article 1, §10 of the United States Constitution, prohibit the impairment by State law of the obligation of a contract. Vested rights acquired under contract may not be destroyed by subsequent State legislation or even by an amendment of the State Constitution. (Citations omitted.)

> In this case plaintiffs, who had been judges and contributing members of the judges' retirement system, elected to and did retire under the governing act. Under that act and particularly section 12 thereof, they, thereupon, ceased to be members of the system. When they so retired and ceased to be members of the system, their contract was completely executed and their rights thereunder became vested. These could not, thereafter, be diminished or impaired by legislative change of the judges' retirement statute. In support hereof see: *State* v. *City of Jacksonville Beach (Fla.)*, 142 So 2d 349 (affirmed 151 So 2d 430); *Bardens* v. *Board of Trustees of Judges Retirement System*, 22 Ill 2d 56 (174 NE2d 168); *Jensen* v. *Pritchard*, 120 Ind App 439 (90 NE2d 518); *Clarke* v. *Ireland*, 122 Mont 191 (199 P2d 965); *Ball* v. *Board of Trustees of the Teachers Retirement Fund*, 71 NJL 64 (58 A 111); *Crawford* v. *Teachers Retirement Fund Association*, 164 Or 77 (99 P2d 729); *Board of Trustees of Police Pension & Retirement System* v. *Kern* (Okla), 366 P2d 415.
>
> * * *
>
> We hold that a valid contract was entered into between judges and the State, that the State's agreement thereunder to pay the judges certain benefits created vested rights for the judges upon their retirement, that these are enforceable and cannot be impaired or diminished by the State. This should be deemed to include not only the benefits provided by statute at the time of entry into the contract and of retirement, but, also, those later added by statutory amendment. The legislature may add to but not diminish benefits without running afoul of constitutional prohibition against impairment of the obligation of a contract.

378 Mich at 180-182; emphasis added.

It is significant to note that Campbell, *supra*, was not decided upon the basis of Mich Const 1963, art 9, §24, but on the rights that arose prior to the effective date of Mich Const 1963. It was decided, as was the trial court's and Court of Appeals'

Decisions herein, upon the general non-impairment clauses in the federal and Michigan Constitutions, *i.e.*, US Const, art I, §10 and Mich Const 1963, art 1, §10.[4]

There can be no doubt from the reading of Campbell, *supra*, that the Supreme Court, leaving aside the language of the newly-adopted but inapplicable Mich Const 1963, art 9, §24, believed that the Legislature's grant of certain retirement benefits was vested and contractual for the retired circuit judges. Similarly, the retirants from MPSERS have, as both the trial court and Court of Appeals Decisions held, vested

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[4]That state's statutes may create contractual obligations on the part of the State which are protected under the federal non-impairment clause has been clear since Fletcher v Peck, 10 US 87; 3 L Ed 162 (1810). Therein Chief Justice Marshall stated:

> If, under a fair construction the constitution, grants are comprehended under the term contracts, is a grant from the state excluded from the operation of the provision? Is the clause to be considered as inhibiting the state from impairing the obligation of contracts between two individuals, but as excluding from that inhibition contracts made with itself?
>
> The words themselves contain no such distinction. They are general, and are applicable to contracts of every description. If contracts made with the state are to be exempted from their operation, the exception must arise from the character of the contracting party, not from the words which are employed.

Justice Marshall then concluded:

> It is, then, the unanimous opinion of the court, that, in this case, the estate having passed into the hands of a purchaser for a valuable consideration, without notice, the state of Georgia was restrained, either by general principals which are common to our free institutions, or by the particular provisions of the constitution of the United States, from passing a law whereby the estate of the plaintiff in the premises so purchased could be constitutionally and legally impaired and rendered null and void.

contractual rights to health benefits under Section 91(1) of the Retirement Act, which are protected by US Const, art I, §10 and Mich Const 1963, art 1, §10.

The Court's decision in Campbell, *supra*, is consistent with the earlier pronouncements of the Michigan Supreme Court in impairment cases. For example, in Ramey v Michigan Public Service Comm'n, 296 Mich 449; 296 NW 323 (1941), the Michigan Civil Service Commission attempted to deprive the plaintiffs, by Public Service Commission Rule, of certain accrued vacation pay which they had earned under prior Public Service Commission Rules. In ruling for the state employees, the Michigan Supreme Court stated:

> Under the facts in this case, plaintiffs had performed all acts necessary to insure to themselves the right of a vacation with pay, or if dismissed before exercised, to receive compensation for the unused portion of their annual leave allowances. There was nothing remaining for them to do except exercise the right which depended on no contingency, but was complete and matured. In my opinion, vacation with pay is not a gratuity; it is compensation for services rendered. It is a rule that after the services are rendered under a law which fixes the rate of compensation, there arises an implied contract to pay for those services at that rate and the contract cannot be impaired by subsequent legislation. Fisk v Jefferson Police Jury, 116 US 131 (6 S Ct 329; 29 L Ed 587); Robertson v Miller, 276 US 174 (48 S Ct 266; 72 L Ed 517).

296 Mich at 461-462; emphasis added.

The Court's language in Ramey sounds very much like Delegate Richard VanDusen's statements on the floor of the 1961-62 Constitutional Convention where he stated pension benefits were "deferred compensation" for work already performed and, accordingly, should be accorded protection from impairment and diminishment by subsequent legislative action. (*See*, Richard VanDusen's

comments at the Official Record of the 1961 Constitutional Convention of the State of Michigan, at 770-771.)

Plaintiffs-Appellees also contend that their health benefits under MCL 38.1391(1) are "contractual" and "vested" and are protected from diminishment or impairment pursuant to Mich Const 1963, art 9, §24. Plaintiffs will not here reiterate the arguments as to why their rights are protected from diminishment or impairment under Mich Const 1963, art 9, §24. Those arguments are fully set forth in their Brief on Appeal filed November 12, 2004, which is to be argued and submitted to the Court together with this case. The reasons they are "contractual" and "vested" under that provision are the same as the reasons they are for the purpose of the general non-impairment clauses in the federal and Michigan Constitutions.

Tyler v Livonia Public Schools, 220 Mich App 697; 561 NW2d 390 (1996), *aff'd on other grounds* 459 Mich 382; 590 NW2d 560 (1999), involved an appeal from the workers' compensation appellate commission (WCAC). The WCAC decision granted the plaintiff workers' compensation disability benefits, but allowed the defendant school district to coordinate those benefits with the plaintiff's disability pension from MPSERS. The question before the Court of Appeals was whether the disability pension benefits could be coordinated against the school district's workers' compensation liability. The plaintiff asserted that the coordination of benefits by the defendant would violate the plaintiff's rights under Mich Const 1963, art 1, §10 and art 9, §24. The Court of Appeals affirmed the WCAC's decision permitting the school district to coordinate benefits, but in the course thereof made it clear that the Legislature could not have modified or amended the statutory program for persons who were already

disabled and whose rights to the disability pension had been vested prior to the amendments to the Workers' Disability Compensation Act. In the course of its decision, the Court of Appeals stated:

> In recognizing that the reference in subparagraph 14 to "plans" refers only to contractual obligations, the Legislature reveals that it properly concerned itself with constitutional limitations on its authority. But for its inclusion of such a provision, the entire section might be declared unconstitutional as an impairment of the obligation of contracts, in violation of Const 1963, art 1, §10 and US Const, art I, §10. (Citations omitted.) . . . The Legislature thus applied coordination to contractual plans only if such plans are renewed or created after March 31, 1982, because the constitutional impediment does not apply to contracts made after the effective date of a statute. . . .
>
> * * *
>
> Hence, the legislature is not constrained by the Impairment of Contracts Clauses of the state and federal constitutions in modifying or amending statutory pension programs before the time the rights thereunder become fixed.

561 NW2d at 393; emphasis added.

Applying the teachings of Campbell, *supra*, Ramey, *supra*, and Tyler, *supra*, to the facts of the current case, it is beyond serious contention that the health benefits of the current retirants from MPSERS vested upon their retirement from public school employment, that they were contractual, and that they were subject to the protection of the non-impairment clauses in the federal and Michigan Constitutions. This is precisely what the trial court and Court of Appeals held herein.

Like the Michigan Supreme Court's decisions in Campbell, *supra*, and Ramey, *supra*, courts in many states have held that retirement benefits are vested and contractual, and cannot be diminished or impaired by the governmental unit granting

them. (*See*, Oregon State Police Officers' Ass'n v State of Oregon, 323 Ore 356; 918 P2d 765 (1996); City of Jacksonville Beach v Florida, 151 S2d 430 (1963); California Teachers Ass'n v Cory, 155 Cal App 3d 494; 202 Cal Rptr 611 (1984); and Nevada Employees Ass'n, Inc v Keating, 903 F2d 1223 (CA 9, 1990) *cert den* 498 US 999; 111 S Ct 558 (1990).)

A recent Alaska case strongly supports the Court of Appeals' ruling that the health benefits provided under Section 91(1) of the Retirement Act are "vested" and "contractual" and hence subject to constitutional protection. In Duncan v Retired Public Employees of Alaska, Inc *et al*, 71 P3d 882 (2003), state officers in charge of administering that state's public employees retirement system sought a declaratory ruling as to whether certain changes in the state's health benefit package to retirees violated Alaska Const, art XII, §7 which protected accrued benefits from the state's retirement system from diminishment or impairment. The Alaska court had to decide whether health benefits were, in effect, contractual in nature and hence "accrued benefits" within the meaning of Alaska Const, art XII, §7. The Alaska court stated:

> In the present case there is little question that the phrase "accrued benefits" as used in art XII, §7 of the Alaska Constitution, if given its natural and ordinary meaning, would encompass health insurance benefits offered to public employee retirees.

71 P3d at 887.

The Alaska Supreme Court clarified that the grant of health benefits was contractual. The Court stated:

> Our case law suggests that "accrued benefits" should be defined broadly. In Hammond v Hoffbeck we held that death benefits payable to the beneficiaries of retirees were encompassed. We stated:

> The fact that part of an employee's benefit package is, effectively, a life insurance policy, the proceeds of which will never be received by the employee, does not make that whole package any less an element of the consideration that the state contracts to tender in exchange for services rendered by the employee.
>
> To paraphrase the above language, medical insurance is also part of an employee's benefit package and the whole package is an element of the consideration that the state contracts to tender in exchange for services rendered by the employee.

Id; footnote omitted.

The above language of the Alaska Supreme Court is very close to the language used by the Court of Appeals herein which is the subject of Defendants-Appellants' appeal. The Court of Appeals stated, at p 10:

> Health insurance is part of an employee's benefit package and the whole package is an element of consideration that the state contracts to tender in exchange for services rendered by the employee.

This holding of the Michigan Court of Appeals in the current matter is both logical and consistent with this Court's ruling in Campbell, *supra*, where the Court stated:

> We hold that a valid contract was entered into between judges and the State, that the State's agreement thereunder to pay the judges certain benefits created vested rights for the judges upon their retirement, that these are enforceable and cannot be impaired or diminished by the State.

378 Mich at 181.

Like the employees in all of the above-cited cases, the retirees from MPSERS do not commence receiving their health benefits until they have completed

many years of employment and are receiving a retirement allowance under the Retirement Act. There is nothing left for the employees to do except receive their retirement benefits. As the courts in so many states have held, at that point (and in some cases prior thereto), the employees' rights become both vested and contractual and are entitled to protection from subsequent diminishment or impairment by the government.

B. Defendants-Appellants would have the Courts misapply the standard for determining if a statutory contract was created.

Defendants-Appellants argue that a statute creates a contract only if the Legislature has unambiguously expressed an intent to create an obligation, the statute is susceptible of no other reasonable construction, the Legislature covenants that it will not be amended, and the statute does not surrender an essential attribute of the State's sovereignty. (*See*, Defendants-Appellants' Brief on Appeal, pp 12-17.)

Defendants-Appellants cite several cases to support their argument that the Court of Appeals and Trial Court misapplied the standards for determining if Section 91(1) of the Retirement Act creates contractual rights to health benefits, namely, National Railroad Passenger Corp v Atchison, Topeka and Santa Fe Railway Co, 470 US 451; 105 S Ct 1441; US Trust Co, *supra*; Butler v Commonwealth of Pennsylvania, 51 US 402; 13 L Ed 472 (1851); Spiller v State of Maine, 627 A2d 513 (1993); In Re Certified Question, 447 Mich 765; 527 NW2d 468 (1994); Romein v General Motors Corp, 436 Mich 515; 462 NW2d 555 (1990); and National Ed Ass'n-Rhode Island v Retirement Bd, 172 F3d 22 (CA 1, 1999). These cases are either irrelevant, inapplicable to the current situation, or, in some cases, *supportive* of the

Court of Appeals' conclusion that Section 91(1) of the Retirement Act creates contractual rights to health benefits for Michigan retired public school employees.

In National Railroad Passenger Corp, *supra*, several railroad companies challenged the constitutionality of a provision in the congressional act establishing Amtrak, which required them to reimburse Amtrak for free pass travel of their employees, former employees, and dependents.

Congress passed the Rail Passenger Services Act of 1970 (RPSA), 45 USC §501, *et seq*, in an effort to revive this country's failing intercity passenger train industry. The RPSA established the National Railroad Passenger Corporation, which subsequently became known as Amtrak. The Act also outlined a procedure under which private railroads could obtain relief from their passenger service obligations by transferring those responsibilities to Amtrak. This would take place by the private railroads signing "Basic Agreements" with Amtrak. The plaintiff railroads entered into those Basic Agreements with Amtrak. However, in 1972, Congress amended the RPSA adding Section 405 which required a private railroad desiring to take advantage of the RPSA to reimburse Amtrak for the free pass travel of their employees, former employees, and dependents. The plaintiffs, five private railroads, alleged that since Congress had contracted in the RPSA to relieve the railroads of intercity rail passenger service, and the railroads had fulfilled their obligations under the Basic Contracts, they had a right to be free from the responsibility to provide free pass privileges. Congress, they claimed, was impairing its contractual obligation through passage of Section 405. Alternatively, the railroads argued that even if the RPSA was not a contractual obligation of the federal government, the Basic Agreements, with identical

"relief from responsibility" language, were such a contractual obligation of the United States. That obligation, the railroads asserted, was unconstitutionally impaired by the subsequent passage of Section 405. In rejecting the private railroads' arguments, the United States Supreme Court first held that the RPSA was not a contract with the United States government, citing the language which Defendants-Appellants herein quoted in their Brief. (*See*, Defendants-Appellants Brief on Appeal, p 13.) In denying the railroads' alternative argument that Section 405 impaired the prior contractual relationship between the private railroads and Amtrak, the Supreme Court stated:

> Because, as we have demonstrated, neither the Act nor the Basic Agreements created a contract between railroads and the United States, our focus shifts from a case in which we confront an alleged impairment, by the Government, of its own contractual obligations, to one in which we face an alleged legislative impairment of a private contractual right. We therefore have no need to consider whether an allegation of a governmental breach of its own contract warrants application of the more rigorous standard of review that the railroads urge us to apply.[24] Instead, we turn to consider whether the payment obligation in section 405(f) of the Act unconstitutionally impairs the private contractual rights of the railroads.

Id, at 471; emphasis added.

Footnote 24 in the citation above states:

> This Court once observed:
>
> There is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority, and the power of the Congress to alter or repudiate the substance of its own engagements. . . . To say that the Congress may withdraw or ignore that pledge is to assume that the Constitution contemplates a vain promise, a pledge having no other sanction than the

> pleasure and convenience of the pledgor. This Court has given no sanction to such a conception of the obligations of our Government. Perry v United States, 294 US 330, 350-351 (1935).
>
> Thus, the Court has observed that in order to maintain the credit of public debtors, *see* Lynch v US, 292 US 571, 580 (1934), and because the "State's self-interest is at stake," United States Trust Co v New Jersey, 431 US 1, 26 (1977), the Government's impairment of its own obligations perhaps should be treated differently. *See also* Allied Structural Steel Corp v Spannus, 438 US 234, 244, n. 15 (1978). It is clear that, where the Government is not a party to the contract at issue, these concerns are not implicated, and there is no reason to argue for a heightened standard of review.

Id; emphasis added.

A careful reading of National Railroad Passenger Corp, *supra*, discloses that, based on the factual situation in the present case, Section 91(1) clearly creates a contract by the State of Michigan to provide health benefits to MPSERS retirees. The Retirement Act, unlike the congressional act involved in National Railroad Passenger Corp, *supra*, is not an economic regulatory scheme but one establishing retirement benefits for public school employees who stayed employed long enough in Michigan public schools to warrant receiving pension benefits from MPSERS. The Retirement Act clearly establishes the contractual right for retirees and MPSERS to receive both pensions and health benefits. There are no additional prerequisites for a retiree from MPSERS to receive health benefits from the Retirement System other than they are receiving a pension therefrom. Given the critical factual differences between the present case and those in National Railroad Passengers Corp, *supra*, that case reinforces Plaintiffs-Appellees' claim that Section 91(1) did, indeed, create contractual

rights to health benefits and that the State's action is subject to the far stricter scrutiny required by US Trust Co, *supra*.

Defendants-Appellants also cite Butler v Commonwealth of Pennsylvania, *supra*, in an attempt to bolster its argument that Section 91 of the Retirement Act does not create contractual obligations on the part of the State. In Butler, *supra*, the plaintiffs alleged that where the State of Pennsylvania reduced their pay as Board of Canal Commissioners, from $4 per day to $3 per day during their time of appointment, such reduction in salary violated the impairment of contracts clause in the United States Constitution. In rejecting that argument, the United States Supreme Court:

> The contracts designed to be protected by the tenth section of the first article of that instrument are contracts by which perfect rights, certain definite, fixed private rights of property, are vested. . . . The promised compensation for services actually performed and accepted, during the continuance of the particular agency, may undoubtedly be claimed, both upon principles of compact and of equity; but to insist beyond this on the perpetuation of a public policy either useless or detrimental, and upon a reward for acts neither desired nor performed, would appear to be reconcilable with neither common justice nor common sense.

541 US at 416; emphasis added.

The United States Supreme Court made the very important distinction between compensation promised on the basis of work actually performed and that which had not been performed.

Applying the teachings of Butler, *supra*, to the circumstances in the current case, we see that Plaintiffs-Appellees are making a claim based upon work actually performed and accepted by the State of Michigan during their employment. Accordingly, the Butler case strongly supports the claim of Plaintiffs-Appellees for the

"deferred compensation" for work already performed by them and accepted by their employers.

Defendants-Appellants' reliance on Spiller v State of Maine, *supra*, is also misplaced. In 1992, due to an economic downturn, the Maine legislature amended the state employees retirement statute to modify ". . . prospective retirement benefits for all state employees with fewer than seven years of creditable service as of December 1, 1991." Defendants-Appellants accurately state in their Brief that ". . . the Maine Supreme Court held that no contract had been established by the Legislature because there was 'no clear indication of a legislative intent to create immutable contracted rights for all State employees'." (*See*, Defendants-Appellants' Brief on Appeal, p 17; emphasis added.) Although this statement is technically accurate, it is taken entirely out of context to the Maine Supreme Court's holdings in Spiller and out of context regarding the factual situation presented to the Court therein. Defendants-Appellants fail to point out to this Court the significant limitations the Maine Supreme Court placed on its holdings in Spiller, *supra*. For example, the State's Brief herein failed to point out the following statements of the Court in Spiller:

1. At footnote 1 on p 514, the Court stated:

> In deciding this case, we do not address the rights of those state employees who have, pursuant to 5 MRSA Section 17851 (1989 R Supp 1992), qualified for service retirement benefits.

The amendatory legislation did not apply to anyone who had retired or those employees who were still working but had earned enough credits to retire.

2. The Spiller Court placed further limitations on its opinion that have direct applications to the facts of the present case:

> Although we reject the Superior Court's conclusion that the retirement statute creates immutable contractual rights on acceptance of employment that cannot be impaired under the contract clauses of our constitutions, retirement benefits are more than a gratuity to be granted or withheld arbitrarily at the whim of the sovereign state. n 12 *see* Note, Public Employees Pensions in Times of Fiscal Stress, 90 Harv L Rev 992, 994-95 (1977).

627 A2d at 517; emphasis added.

Footnote 12 referred to in the quotation above states, *inter alia*:

> We have said that state employees have legitimate retirement expectations. (Citations omitted.) Those expectations may constitute property rights that the legislature cannot deprive them of without due process of law. (Citations omitted.) Alternatively, the State may be estopped from changing certain benefit provisions in the retirement statutes. *See* Christensen v Minneapolis Mun Employees Bd, 331 NW2d 740, 748 (Minn 1983).
>
> The changes made in this case, however, do not result in a violation of due process. Nor is the State estopped from making them. We do not here determine whether additional changes to the retirement statute would implicate the contract, takings (*see* Note Harv L Rev at 1003-04) or due process clauses of our constitutions, or the doctrine of promissory estoppel.

Id.

As with so many of the cases cited by Defendants-Appellants in its Brief, the Maine Supreme Court's opinion in Spiller actually supports the position of Plaintiffs-Appellees in the present case, all of whom are retired and have totally vested rights to retirement benefits under the Michigan Public School Employees Retirement Act.

The Attorney General's reliance on this Court's opinions in In Re Certified Question, *supra*, and Romein, *supra*, is entirely misplaced.

In Re Certified Question, *supra*, involved a claim by policyholders of workers' compensation insurance to certain surpluses which had been created by the administration of Michigan's workers' compensation program under the Workers' Disability Compensation Act. The plaintiffs therein claimed the Workers' Disability Compensation Act created contract rights that could not be diminished or impaired under this State's constitutional non-impairment clause. This Court analyzed the Workers' Disability Compensation Act and concluded that it remained only a general statement of policy and not an agreement between the State and the policyholders for specific premiums. Accordingly, any surpluses resulting from premiums paid in excess of those necessary to pay for the disability benefits were not contractual in nature.

In Romein, *supra*, this Court rejected an injured employee's assertion that the Workers' Disability Compensation Act created a contractual right to a certain level of benefits that the plaintiff claimed could not be reduced by subsequent legislation which permitted the coordination of benefits with an employer-funded pension plan. This Court found no language in the Workers' Disability Compensation Act creating a right to receive a specific monetary benefit that could not be adjusted by subsequent legislation.

Accordingly, the cases cited by Defendants-Appellants are entirely distinguishable on their facts from the present case. Those cases cited by Defendants-Appellants do not involve retirement benefits and did not involve employees who had completed a long period of employment in return for health benefits.

In summary, the cases relied upon by Defendants-Appellants for their assertion that health benefits under Section 91(1) of the Retirement Act are not contractual, are irrelevant, and are factually distinguishable. They do not represent the thinking of Michigan courts or the appellate courts of numerous other states on the issue presented here.

C. The courts, the Michigan Legislature, and Congress have historically given retirement benefits a much higher degree of protection than other types of benefits.

Although health benefits are not treated the same as pension benefits under the federal Employment Retirement Income Security Act (ERISA), courts have gone to great lengths to protect employees' retirement benefits from impairment or diminishment once those benefits are vested. ERISA, for example, contains an anti-cutback provision, pursuant to which a retirant's accrued pension benefits may not be reduced. In the recently-decided case of Central Laborers' Pension Fund v Heinz, 124 S Ct 2230; 159 L Ed 2d 46 (2004), retired employees sued the pension fund alleging that the application of an amended definition of "disqualifying employment" to suspend payment of their accrued pension benefits violated the anti-cutback rule of ERISA. Upholding the Seventh Circuit's decision that the amended definition of "disqualifying employment" violated ERISA's anti-cutback rule, the United States Supreme Court stated:

> There is no doubt about the centrality of ERISA's object of protecting employees' justified expectations of receiving the benefits their employers promise them.
>
> > Nothing in ERISA requires employers to establish employee benefits plans. Nor does ERISA mandate what kind of benefits employers must provide if they choose to have

> such a plan. ERISA does, however, seek to ensure that employees will not be left empty-handed once employers have guaranteed them certain benefits. . . . [W]hen Congress enacted ERISA, it "wanted to . . . mak[e] sure that if a worker has been promised a defined pension benefit upon retirement -- and if he has fulfilled whatever conditions are required to obtain a vested benefit -- he actually will receive it."

124 S Ct at 2235; citations omitted; emphasis added.

The same thing must be said about the non-impairment provisions in the United States and Michigan Constitutions. Nothing in those Constitutions require the Legislature to give public school employees pensions or health benefits, but once it gives those benefits, the non-impairment clauses in the Constitutions were intended to protect employees' justifiable expectations that they will receive those benefits when they retire. When it comes to retirement benefits, the drafters of the 1963 Constitution wanted to make it absolutely clear that benefits from "pension plans and retirement systems of the state and its political subdivisions" were contractual in nature and would not be subjected to diminishment or impairment.

ERISA does not give the same protection to health benefits as it does to pension benefits. Nevertheless, federal courts have concluded that parties may as a matter of contract give employees rights which may not be diminished or impaired. Such protection is a question of contractual commitment. In UAW v Yard-Man, Inc, 716 F2d 1476 (6th Cir. 1983), the United States Sixth Circuit Court of Appeals discussed the circumstances under which retirees may enforce their rights to contractually-promised health benefits. The Court stated:

> As in all contracts, the collective bargaining agreement's terms must be construed so as to render none nugatory and avoid illusory promises.

716 F2d at 1480.[5]

The Court then analyzed the language and circumstances under which health benefits were given to retirees in the collective bargaining agreements. In holding that retirees were contractually entitled to lifetime health benefits, the Sixth Circuit looked at six criteria, including such factors as:

1. The employer's course of conduct in continuing retiree benefits after plant closures beyond the point at which insurance benefits could have been eliminated for active employees.

2. The context in which the benefits were given.

3. The fact that retiree benefits are "status" benefits which carry with them an inference that they continue so long as the prerequisite status is maintained.

Applying the criteria the Sixth Circuit used in Yard-Man, *supra*, to the facts of the present case makes it inescapably clear that the health benefits granted to retirees were contractual. For example, when MPSERS retirees raised concerns over the continued validity of their health benefits in 1992, the State's chief executive officer, Governor Engler, and the State's chief financial officer, Douglas B. Roberts, each wrote letters to the members of the MPSERS and the retirees therefrom assuring them that their health benefits were secure and constitutionally protected. Governor Engler's

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[5]Similarly, other courts have held that public employee pension statutes are to be construed liberally in favor of the recipients. *See* State of Delaware v Dineen, 409 A2d 1256, 1260 (1979); Miller v City of Wilmington, 285 A2d 443, 446 (1971); and McCalpin v Retirement Bd of the Fireman's Annuity and Benefit Fund of Chicago, 2004 US Dist LEXIS 14285 (July 27, 2004).

letter stated: "This change was merely a change in funding source and will have no impact on any of your benefits, this year or in the future." (PA 890a.) State Treasurer Robert's letter to the members and retirees stated:

> Your retiree health benefits are not in jeopardy in any way.
>
> Your basic pension benefits are protected under the Michigan Constitution . . . . Again, your MPSERS benefits would not be affected.

PA 90a.

The statements of the Governor and State Treasurer are entirely consistent with the language found at page 2 of the Benefit Booklet distributed to MPSERS members and retirees. The Benefit Booklet states:

> Your beneficiary may continue coverage in the Master Health Care Plan after your death only if you chose a survivor option (2, 2-E, 3, or 3-E) that provides an ongoing monthly benefit under the pension plan. If you chose option 1 or 1-E, that does not provide a survivor benefit, subsidized group coverage does not continue.

PA 101a.

This language clearly confirms to members and retirees that they may rely on having health coverage for their life and, if they choose, certain pension options for the life of their surviving beneficiaries. The retirees' and beneficiaries' health benefits are tied directly to pension benefits. If a member is entitled to a monthly retirement allowance under the Retirement Act, they are automatically entitled to the health benefits provided for under Section 91(1). That is what Section 91(1) expressly provides.[6]

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[6]Section 91(1), MCL 38.1391(1), states: "The retirement system shall pay the entire monthly premium or membership or subscription fee for hospital,

Finally, the health benefits to MPSERS retirees, like those referred to in Yard-Man, *supra*, are "status benefits" and as such carry with them the strong inference that they were intended to last as long as the individual remains a retiree.

Applying the language of Section 91(1) to the actions of the State in administering that statutory language for many years, there can be no doubt that the health benefits provided for in Section 91(1) are a contractual commitment of the State of Michigan to its public school employees.

D. Defendants-Appellants' argument that the Court of Appeals' Decision will lead to the conclusion that all other statutes using the word "shall" will be deemed to have created a contractual obligation is meritless.

In a desperate attempt to convince this Court to reverse the Court of Appeals' Decision, Defendants-Appellants argue that the Court of Appeals' determination that Section 91 of the Retirement Act creates contractual rights to health benefits will effectively render every other statute using the word "shall" as being contractual. This is nonsensical, improper, and illogical.

Defendants-Appellants initiate this argument by stating the Court of Appeals' Opinion on this issue was based on an incomplete analysis and that it can be inferred from the Opinion that the use of the word "shall" in Section 91 imposes a contractual obligation upon Defendants-Appellants.

The Court of Appeals clearly conducted a thorough analysis of Section 91, based on the following language from its Opinion:

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medical-surgical, and sick care benefits for the benefit of a retirant or retirement allowance beneficiary who elects coverage in the plan authorized by the retirement board and the department."

> . . . the language of MCL 38.1391(1) demonstrates a clear expression of legislative intent to create contractual rights for public school employees. Health insurance is part of an employee's benefit package and the whole package is an element of consideration that the state contracts to tender in exchange for services rendered by the employee. (Emphasis added.)

The emphasized portion of the Opinion clearly establishes the Court of Appeals' well-reasoned analysis of Section 91. Defendants-Appellants' inference that the term "shall" was the basis of the decision is unfounded. Even more unfounded is Defendants-Appellants' speculative assumption that all statutes using the word "shall" will thus be deemed to be contractual in nature. The Court of Appeals' independent and thorough analysis of Section 91 of the Retirement Act has absolutely no bearing on other acts that require similar analysis. Whether the Legislature's use of the word "shall" in any particular case creates contractual rights depends on the nature of the rights granted and the facts and circumstances surrounding the legislative grant.

Defendants-Appellants in the instant case have clearly failed to show that the legislative intent behind Section 91 of the Retirement Act will be frustrated by the Court of Appeals' interpretation.

E. The State is estopped from denying the contractual nature of health benefits under Section 91(1) of the Retirement Act.

In Musselman v Governor, 448 Mich 503; 533 NW2d 237 (1995) *on rehearing* 450 Mich 574; 545 NW2d 346 (1996), the State expressly acknowledged that health benefits were contractual and subject to protection from impairment or diminishment under Mich Const 1963, art 1, §10.

At p 34 of their July 29, 1991 Court of Appeals' brief, the MPSERS and other State defendants stated:

> The Record of the Constitutional Convention does not appear to contain any specific reference to health benefits. While this does not support a conclusion that post-Const 1963 provision of health benefits are not benefits protected from impairment or diminishment, it does suggest that the method of funding such benefits was not considered by the Framers.

PA 48a; emphasis added.

In its September 20, 1991 brief to the Court of Appeals in Musselman, the State defendants once again reiterated this theme where it said, at p 4:

> While Executive Order 1991-17 unambiguously changes the funding method for health insurance coverages under 1980 PA 300 for this fiscal year ending September 30, 1991, a covered individual has no less security or coverage than before the Executive Order took effect. The legislative, and constitutional, commitment to deliver the promised benefit when due is both achieved and safe-guarded. Defendants assert that health care benefits continue to be funded on an actuarial basis.

PA 52a; emphasis added.

At pp 69-70 of their August 30, 1993 Supreme Court Brief in Musselman, the State defendants stated:

> There was extensive debate within the committee, and the committee ultimately approved wording containing the specific language "accrued financial benefits." The record of the Constitutional Convention does not appear to contain any reference to health benefits. This is not surprising since no state retirement system in Michigan provided for such benefits until the mid-1970s. While this does not support a conclusion that post-Const 1963 provision of health benefits are not benefits protected from impairment or diminishment under other provisions of Const 1963, such as art 1, §10, it does support the conclusion that provision of such benefits and thus their funding was not considered by the Framers of art 9, §24.

PA 55a - 56a; emphasis added.

Again, at p 78 of its August 30, 1993 Supreme Court brief, the State defendants stated in the section of their brief titled "SUMMARY":

> The available appropriated funds (and previously-appropriated funds and earnings in the Section 34 Reserve) are sufficient to pay the costs of all health benefits promised under Section 91 of 1980 PA 300, which contractual obligation is subject to art 1, §10.

PA 57a; emphasis added.

In essentially every major brief it filed in Musselman, *supra*, the State defendants assiduously acknowledged that the health benefits provided for in Section 91(1) of the Retirement Act were a contractual obligation of the State of Michigan and protected from diminishment and impairment under Mich Const 1963, art 1, §10. Given these numerous statements by the State Defendants, they are judicially estopped from denying the contractual nature of such benefits in this matter. (*See* Hassberger v General Builders' Supply Co, 213 Mich 489; 182 NW 27 (1921) and Connor v Lake Shore and Michigan Southern Railway Co, 168 Mich 29; 133 NW 1003 (1911).) In Hassberger, *supra*, a defendant in a suit for specific performance claimed that no valid contract existed between it and the plaintiff; it was estopped from claiming later, in an action against it to recover the money paid under said contract, that a contract existed. In so ruling, the Michigan Supreme Court said:

> The rule that a party will not be allowed to maintain inconsistent positions in judicial proceedings is not strictly one of estoppel, partaking rather of positive rules of procedure based on manifest justice and, to a greater or lesser degree, on considerations of the orderliness, regularity, and expedition of litigation.
>
> It may be laid down as a general rule that a party will not be allowed in a subsequent judicial proceeding to take a position in conflict with a position taken by him in a former

> judicial proceeding, where the later position is to the prejudice of the adverse party, and the parties and the question involved are the same.

213 Mich at 495; citations omitted.

Given the many times which the State asserted in Musselman, *supra*, that health benefits were contractual and protected by the non-impairment clauses in the Michigan and federal Constitutions, it should be judicially estopped from claiming herein that Section 91(1) health benefits are not contractual.

SUMMARY AND CONCLUSION

The health benefits granted to retirees pursuant to Section 91(1) of the Retirement Act, MCL 38.1391(1), are, as to those persons who have retired and are receiving such health benefits, "vested" and "contractual." The contractual nature of the benefits is derived from the fact that the retirants from MPSERS worked for many years in reliance on the State's promise to provide them with health benefits upon their retirement. Now that the retirants have completed their side of the bargain, have retired from their employment, and are no longer members of MPSERS, it is unthinkable that the State could pull the economic rug out from under them while substantially diminishing or impairing the value of their contractual right.

The only issue raised by Defendants-Appellants in their Brief on Appeal is whether the Court of Appeals improperly held that Plaintiffs-Appellees' health benefits were a contractual obligation of the State. The Court of Appeals held that it was contractual, but upheld the granting of Defendants-Appellants' Motion for Summary Disposition on the grounds that MPSERS' increase in the co-pays and deductibles complained of herein did not amount to a "significant" impairment of the State's

contractual obligation. That holding is the subject of Plaintiffs' Brief on Appeal filed on November 12, 2004.

RELIEF

Because it is absolutely clear that Section 91(1) of the Retirement Act creates contractual, vested rights on behalf of MPSERS' retirants, Plaintiffs-Appellees respectfully request that this Court affirm the Court of Appeals' Decision on this issue.

Respectfully submitted,

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Dated: December 23, 2004

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